BILL # SB 1388

TITLE: tax credits; research and development

SPONSOR: Martin

STATUS: As Introduced

REQUESTED BY: Senate

PREPARED BY: Tim Everill

FISCAL ANALYSIS

Description

The bill would change the formula for the research and development (R&D) tax credit (both corporate and individual). The credit is based on the amount of the taxpayer's qualifying research expenses in Arizona. The current formula calculates the income tax credit as 20% of the first $2.5 million in qualifying expenses plus 11% of the amount exceeding $2.5 million. The bill would change the percentage of credited expenses above the $2.5 million threshold from 11% to 20%.

Estimated Impact

JLBC Staff cannot independently estimate the impact of the bill as we do not have access to confidential taxpayer data. Based on data provided by the Department of Revenue (DOR), this bill could result in a direct General Fund revenue loss of $(15) million to $(20) million beginning in FY 2006.

While SB 1388 would lead to a direct reduction in corporate and individual tax liabilities, the bill would create a more favorable tax environment. As a result, the bill could generate additional economic activity that would lead to an offsetting increase in tax collections. This type of secondary, or dynamic impact, is difficult to estimate. The State of California has the most advanced state government level dynamic forecasting model. Based on their model, 18% of corporate tax reductions are offset by additional state revenue within 5 years.

Analysis

Based on DOR's preliminary analysis of taxpayer data from TY 2003, increasing the formula percentage from 11% to 20% for TY 2003 would have increased the R&D credit by an estimated $15 million. DOR's estimated annual revenue impact of $(15) million to $(20) million is based on improved economic growth and the expectation that it will continue, as evidenced by the increased level of corporate estimated payments in TY 2004.

In addition, DOR notes that while the estimated impact of versions of this bill in prior years has been significantly less, corporate tax liabilities have increased significantly based on preliminary TY 2003 data, and corporations will be able to take advantage of the credits rather than carrying them forward to subsequent years. The tax credits for qualifying expenses may be carried forward up to 15 years. While we do not know exactly when companies will elect to take the tax credits, increased tax liabilities will afford taxpayers the opportunity to take the credits sooner.

Local Government Impact

Incorporated cities and towns receive 15% of individual and corporate income taxes as urban revenue sharing. Accounting for the two year lag in the distribution of urban revenue sharing, this bill would have an impact on local government beginning in FY 2008. The revenue loss to local jurisdictions would be $(2.2) million to $(3.0) million beginning in FY 2008.

2/17/05